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Federal Communications Commission
Office of Secretary

Morning Meeting Comments

NOVEMBER 8, 1996

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TELECOMMUNICATIONS INDUSTRY UPDATE

ANNA-MARIA KOVACS
TELECOMMUNICATIONS
INDUSTRY UPDATE

The Joint Board's recommendation on Universal Service: future subsidies to local companies will be less than past subsidies.

The Joint Board met yesterday to vote on its recommendation on Universal Service. Our report is based on the discussion at the meeting and on the press releases, which are all that is available so far. The full document will be issued later today or next week.

The Telecom Act of 1996 decreed that subsidies implicit in rates be made explicit. In a competitive world, rates are cost-based. The Act attempts to get to a competitive marketplace as fast as possible by decreeing that subsidies which have been implicit in some rates be made explicit. The Act also decreed that Universal Service be preserved: that telecom services remain available and affordable throughout the country. In particular, it decreed that advanced telecom services be available to schools, libraries and rural healthcare providers. Essentially the Act decreed that the subsidies of basic local rates which have been buried in the prices of other services be made explicit by being moved into Universal Service Funds (USF) at the federal and state levels. The Act instructed the Federal Communications Commission (FCC) to appoint a Joint Board, including three FCC commissioners, four state commissioners and a state consumer advocate to make recommendations to the FCC about the federal rules Universal Service rules and to create the federal USF. The FCC is then to open that recommendation to public comment, and by May 8, 1997, the FCC is to establish rules for federal Universal Service support. The role of the Joint Board is significant, but purely advisory. The final decisions will be made by the FCC next Spring. We highlight that because the views of some state commissioners were very different from those of the FCC members of the Joint Board.

Key Points:

The Board reached agreement on some very key issues. The Board agreed on the definition of Universal Service, increased support to low-income users, set up the education part of the Fund and capped the size of that part of the Fund. It also set up the possibility the Subscriber Line Charge will be lowered somewhat.

Most importantly, it also agreed that support for high cost rural areas should be determined through a proxy model, yet to be finalized, that will be based on forward looking costs, not embedded costs. This means that the Fund will be created bottom-up, with compensation based on the difference between a company's hypothetical efficient cost in a given location minus a national benchmark cost. The compensation will not be based on embedded costs. While the Board did not size the Fund, it is clear that it will not attempt to keep the local companies whole.

The Board did not agree on jurisdiction. Some state commissioners did not want the federal Fund to draw on intrastate revenues. Other state commissioners seem willing to allow that, if the Fund needs to be large. The FCC commissioners all believe they have the authority to draw on intrastate as

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well as interstate revenues for this purpose. Thus, the issue of jurisdiction rears its litigious head again.

Because the Board did not decide whether to use intrastate revenues to feed the federal Fund, it did not size the Fund. It also defined the benchmark it will use to determine need for support on revenues as well as costs. The idea is that a company's costs in a given area will be compared to that national average benchmark, and the gap will be filled by the Fund. Apparently, where the benchmark is set will depend not only on what average forward looking costs are nationwide, but what revenues are available to support those costs. What we infer, in plain English, is that if intrastate revenues cannot be used to feed the federal Fund, the benchmark will be set at a level that results in a small federal Fund and most of the burden of supporting local rates will be left to the states through state Funds.

There are several key bottom line implications to this arcane jurisdictional dispute, and we believe their primary impact will be on local companies. Between the lines, it appears that the burden on long distance companies will be smaller than it has been in the past. The federal Fund will be smaller than current access charges, if long distance revenues alone support it. Alternately, a large fund could be created but it would get much of its support on the basis of intrastate revenues, which are over two thirds of all telecom revenues in the U.S. Thus, the real implication of the jurisdictional issue is not whether long distance companies are the winners. They are. The question is which local companies are the biggest losers. Will low cost states support high cost states, via a large federal Fund based mostly on intrastate revenues, or will each state have to fund itself? Either way, we see the long distance companies as winners. It will, however, make a big difference to the local companies' financials. With a small federal Fund, rural companies like GTE, US West, BellSouth do much worse than with a large federal Fund. Conversely, Bell Atlantic, NYNEX, Ameritech do much better. We expect the FCC, when it makes the final decision in May to opt for a bigger Fund that draws on intrastate revenues. However, we also believe that decision is likely to be appealed in Court.

More detail:

The Joint Board recommends, but the FCC will make the final decisions. The Joint Board recommendations that follow are will be considered by the FCC as it continues to deliberate the issue of Universal Service, but the final decisions will be made by the FCC alone by May 8, 1997. That is a critical point, because on many key issues the FCC commissioners differed from some or all of the state commissioners. Thus, we will highlight the positions of the FCC commissioners in areas where there were disagreements between the state and federal commissioners.

Universal Service is defined as single-party, voice grade access to the public switched network, includes some usage, and access to: operator services, emergency services (911), interexchange services, and directory assistance. Dial-tone multi-frequency signaling must also be available.

Any common carrier who offers all such services throughout its designated service area is eligible for support from the Universal Service Fund (USF) regardless of the technology it uses. Thus, wireless or cable companies, for example, can receive support as long as they provide those basic services. They would also contribute as long as they are interexchange carriers.

To help provide for low-income users, the Board recommends extending Lifeline and Link-Up programs nationwide and increasing the federal subsidy for those in the program from $3.50 to $7 per month.

Support will be provided by the Fund to schools, libraries, and rural healthcare providers. The support for healthcare is left to be fleshed out, but is not expected to be a large amount. For schools and libraries, a sliding scale of discounts on services is to be provided by carriers, who are then compensated by the Fund. Discounts range from 20% for schools and libraries in the wealthiest areas of the U.S. to 90% for those in the poorest. Most will receive discounts of 40-90%. The part of the Fund that supports schools and libraries was capped at $2.25 billion. It was decreed that this part of the Fund be supported by all interexchange carriers based on both interstate and intrastate revenues. That is, both local and long distance companies contribute to this part of the Fund, based on all their revenues net of transfer payments to other carriers (e.g. long distance revenues net of access charges). On the issue of funding, two state commissioners dissented based on their view that the FCC has no jurisdiction over intrastate revenues.

The biggest part of the Fund is likely to be support for rural and high cost areas. The Board did not size this part of the Fund and thus did not size the total Fund. All members of the Board did, however, support the use of a proxy model based on forward-looking costs to determine support needed for rural, high-cost companies. Comments made by various commissioners sized it as potentially several billion in one case, as $5 billion to $15 billion in another case. There was a sense that the size of the federal Fund will depend on whether it draws on intrastate revenues. If it does, it will be fairly large, while if it is based on interstate revenues only it might be fairly small. However, Chairman Hundt, who supports drawing on intrastate revenues, indicated that the federal Fund, including the new support for education, will be much smaller than the total implicit subsidies that support universal service today. Local companies are expected to become more efficient in a competitive world and to need less support than they have in the past.

Prior attempts at sizing the Fund have ranged from $4 billion, submitted by MCI, to $20 billion, submitted by USTA, the association of local phone companies. The USTA number attempts to size subsidies currently implicit in various rates. In the past, access charges and rates on toll and value-added services supported local basic rates at levels below cost in most of the country. In addition, support for the highest-cost rural areas was provided through a high cost fund, which is currently well under $1 billion. Support came from both interstate and intrastate sources through a mixture of subsidies buried in various rates. In addition, through the high cost fund some mostly urban local companies have supported some rural local companies. The totality of such implicit cross-subsidies from all sources has been sized at $20 billion by USTA, the local companies' association. It represents the number required to keep the local companies whole. We believe that number is on the low side, not on the high side. The MCI view is that most of that $20 billion represents inefficiency which should be squeezed out of the system rather than subsidized. MCI and others have submitted proxy models which hypothesize a newly-build efficient network that uses the most modern technologies, and cost out the system based on that basis. Results of such models are far lower than $20 billion.

The Board unanimously agreed on the principle of using a bottom-up proxy model based on forward-looking costs, not embedded costs. It left the thrashing out of the specific model and its inputs to workshops that will be held over the next few months, and thus gave the local companies one more chance to bring in their own versions of forward-looking models that will presumably be more favorable than the ones now before the FCC, most of which were funded by MCI. Thus, it is clear this will not be a make-whole Fund, but the LECs have another chance to submit numbers that keep it from being a disaster for them.

While it is clear that the Board did not agree on jurisdiction, it did agree that the Fund will be

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St. Catherine's School
1003 No. Broad Street
Elizabeth, New Jersey 07208

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Federal Communications Commission
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Federal-State Joint Board on Universal Service
c/o Federal Communications Commission
1919 M St. NW
Washington, DC 20554

Dear Members of the Federal-State Joint Board on Universal Service:

Catholic Schools are under constant budget restraints. Over the past four years I have observed a constant trend to pay more for goods and services. Emergency situations centering around facility needs are causing spending for plumbing and electrical repairs. Additionally, assisting those who have and are suffering economic problems continue to drain our limited resources.

Technology investments can only help all children if the FCC permits discounts rates to assist our school. Significant savingswill permit us to meet the needs of children with your help.

Therefore, I am requesting your recommendation and support to the Federal Communication Commission on November 8, 1966 for:

1. Discounted telecommunications rates for schools and libraries.

2. Basic and advanced services should be eligible for the discounted rates.

Thank you for helping us help children.

Very truly yours,

Peter N. Polidoro, Ed.D.
Principal

PNP/jm

CC: Sr. Suzanne Bellenoit, SSJ
Asst. Supt. Gov. Prog.

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Saint Cecilia School
114 Chestnut Street
Kearny, NJ 07032
November 2, 1996

Dear Board Members,

I am a First Grade teacher at Saint Cecilia School in Kearny, New Jersey. We are very excited about our new computers, which we are leasing from Apple, and were just wired for the Internet. Since we are a private school we depended upon contributions to defray the cost of "Netday". The only ways we can afford investments in technology are from fund-raisers, contributions, and discounts. We are a small school but have a lot of spirit and drive. My students are so excited about using our computer which we have to share with two other classes.

If we are to continue to develop and enhance our technology plans we need you to provide discounted telecommunications rates for schools and libraries. We also need basic and advanced services eligible for discounted rates. I hope you keep us in mind when you make your recommendations to the FCC on November 8.

Thank you,

Mrs Eva M. Reese

Mrs. Eva M. Reese

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